

(1941) 03 CAL CK 0011
In the Calcutta High Court
Case No : Reference No. 13 of 1940

INDIAN IRON AND STEEL COMPANY, LTD., IN RE.

Date of Decision : 10-03-1941

Acts Referred:

Income Tax Act, 1922 — Section 10(2)(vi), 66(2)

Citation : (1941) 9 ITR 539

Hon'ble Judges : Derbyshire, C.J

Bench : Single Bench

Judgement

DERBYSHIRE, C.J. The Commissioner of income tax, Bengal, at the request of the assessee, the Indian Iron and Steel Company, Limited, has stated a case u/s 66(2) of the Indian income tax Act of 1922. The facts of the case are fully stated in the Reference to which are appended Annexure "A", an agreement between the Bengal Iron Company, Limited, and the Indian Iron and Steel Company, Limited, for the transfer of the undertaking and assets of the former to the latter; Schedule I which was a scheme of arrangement agreed to by the shareholders of the Bengal Iron Company, Limited, and confirmed by the English Courts for the purpose of carrying out the transfer and, also, Schedule II which contains special resolutions of the Indian Iron and Steel Company, Limited, passed by that Company's shareholders for the furtherance of the transfer.

Both the concerns carried on in a large way the business of iron smelters and founders and steel makers. The Bengal Iron Company was registered in England under the English Companies Act many years ago; the Indian Iron and Steel Company was registered under the Indian Companies Act

later about the year 1918.

For some years previous to 1936 both the companies made small profits or suffered losses and each was entitled, under the provisions of Section 10(2)(vi) of the Indian income tax Act of 1922 to large amounts of unabsorbed depreciation arising from the fact that in both companies the depreciation allowable under the income tax Act had for several years exceeded the profits earned.

The proper legal formalities regarding the transfer were complied with and such transfer took effect from December 2, 1936.

The transfer itself, as is evidenced by the documents annexed to the case mentioned above, was a complicated transaction but put shortly the relevant portions on it are as follows :-

- (1) The Bengal Iron Company, Limited, went into liquidation;
- (2) The liquidator of the Bengal Iron company transferred to the Indian Iron and Steel Company, which took over on December 2, 1936, the entire undertaking, business, property and assets of the Bengal Iron Company on that date and "the benefit so far as capable of being assigned, of any claim which the Bengal Iron Company may have in respect of unabsorbed depreciation allowances"; and
- (3) The Indian Iron and Steel Company paid off the debenture indebtedness of the Bengal Iron Company, and in return for the shares in the Bengal Iron Company held by its shareholders issued shares in the Indian Iron the Steel Company or, in the alternative, paid cash for the shares.

The Bengal Iron Company ceased to operate as and from December 2, 1936, and the liquidator proceeded to wind up the Company. It is not clear whether the Bengal Iron Company has been finally dissolved by the English Courts or not. It is, however, clear that from December 2, 1936, the Bengal Iron company ceased to carry on business and the whole of its undertaking, properties and assets were transferred to the Indian Iron and Steel Company, who carried on both concerns as one.

An assessment was made upon the Indian Iron and Steel Company for the year 1937-38 in respect of the previous year April 1, 1936, to March 31, 1937 the year of the transfer. It is set out in Annexure "B" to the case and summarised in paragraph 4 of the case.

The Indian Iron and Steel Company appealed against this assessment and the Assistant Commissioner of income tax made an altered assessment which is set out in Annexure "E" and summarized in paragraph 5 of the case.

The question of law arising out of the Assistant Commissioner assessment are set out in paragraph 6. It will be noticed that the Indian Iron and Steel Company, as the successor to the Bengal Iron Company are assessed for the year of the transfer in two parts, namely, (1) in respect of the business of the Bengal Iron Company carried on from April 1, 1936, to December 2, 1936, and (2) for a period December 3, 1936, to March 31, 1937, in respect of the working of the combined concerns.

As regards the working of the Bengal Iron Company from April 1, 1936, to December 2, 1936, there was a profit of Rs. 3,76,162 but that was completely absorbed by the depreciation allowance for the period on the Bengal Iron Companys assets and the unabsorbed depreciation allowance on the Bengal Iron

Company's assets brought forward. These two depreciation allowances amounted altogether to Rs. 91,07,479. There was thus the large depreciation allowance of Rs. 90,31,317 left unabsorbed at the date of the transfer.

The Assistant Commissioner of income tax refused to allow this unabsorbed depreciation allowance of the Bengal Iron Company to be carried forward into the accounts of the Indian Iron and Steel Company. As regards the combined Company, the Assistant Commissioner of income tax allowed the Indian Iron and Steel Company a depreciation of Rs. 7,60,077 in respect of the original buildings, plant, etc., of the old Indian Iron and Steel Company based on the original cost to that Company for the whole year, and a further depreciation allowance in respect of the buildings, plant, etc., acquired from the Bengal Iron Company for the part of the financial year after the transfer, i.e., from December 3, 1936, to March 31, 1937, amounting to Rs. 3,77,767 based on the cost to the Indian Iron and Steel Company of the acquired Bengal Iron Company's assets; in all Rs. 11,33,844. He further allowed the Indian Iron and Steel Company to bring into this account the unabsorbed depreciation allowance that they were entitled to in respect of the original buildings, plant, machinery, etc., of the Indian Iron and Steel Company, namely, Rs. 62,00,775. That made a total depreciation allowance for the year in question of Rs. 73,38,619.

Against that sum of Rs. 73,38,619 was set off the profits of the original Indian Iron and Steel Company's business for the whole year and of the acquired business of the period December 3, 1936 to March 31, 1937; in all Rs. 36,84,324.

The assessee, the Indian Iron and Steel Company, (combined concern) contend that they are entitled also to the balance of the unabsorbed depreciation allowance of Rs. 90,31,317 of the Bengal Iron Company and that they should be allowed to carry this forward into their accounts.

The practical effect of such a contention prevailing would be to render immune from income tax an equal amount (Rs. 90,31,317) of the future profits of the combined concern.

We were informed from the Bar during the hearing of the case, (and in fact it is public knowledge, that large profits have in fact been made by the assessee since the amalgamation, and rupees one crore and seventy lacs thereof distributed to their shareholders. No income tax, we were informed, has as yet been paid by the assessee.

The assessee's contention is based on the following reasoning :

Firstly, the Indian Iron and Steel Company is entitled to the benefit of this unabsorbed depreciation allowance, by virtue of the terms of the assignment, by which it is specifically assigned to them. Again, the Indian Iron and Steel Company is the successor to the Bengal Iron Company within the meaning of Section 26(2) of the Indian income tax Act, as it stood during the year of assessment, which is as follows :

"Where at the time of making an assessment u/s 23, it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for the year."

The reasoning goes on : that if regard is had to Section 26(2) an assessment on a notional basis should be made upon the Indian Iron and Steel Company for the whole of the year of the transfer, i.e., from April 1, 1936, to March 31, 1937; that in such an assessment the assessee would stand in the shoes of the Bengal Iron Company at the beginning of the year and obtain credit for the Bengal Iron Company's unabsorbed depreciation allowance at the beginning of such year, namely, Rs. 85,45,150 together with their own unabsorbed depreciation allowance of Rs. 62,00,775; that at the end of the transfer year they would be entitled to the remaining depreciation allowance derived partly from the Rs. 85,45,150 and the Rs. 62,00,775 together with the current year's depreciation allowance on the whole concern; such sum less profits made during the year would be automatically carried forward to the following year as an allowance against profits and so on for the succeeding years by reason of proviso (b) of Section 10(2)(vi) which runs as follows :-

"Where full effect cannot be given to any such allowance in any year owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following year and deemed to be part of that allowance, or, if there is no such allowance for that year, be deemed to be the allowance for that year, and so on for succeeding years."

No previous case on all fours with this has been cited to us although English cases based on the English income tax Act of 1918, Schedule D, Cases I and II, Rule 6, have been cited. Rule 6, sub-rule (3), bears considerable resemblance to proviso (b) of Section 10(2)(vi) of the Indian income tax Act. I quote Rule 6(3) with Rule 6(1) which leads up to Rule 6(3) :

"6(1). In charging the profits or gains of a trade under this Schedule, such deduction may be allowed as the commissioners having jurisdiction in the matter may consider just and reasonable, as representing the diminished value by reason of wear and tear during the year of any machinery or plant used for the purposes of the trade and belonging to the person by whom it is carried on.

(3) Where full effect cannot be given to any such deduction in any year owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the deduction, the deduction or part of the deduction to which effect has not been given, as the case may be, shall, for the

purpose of making the assessment for the following year, be added to the amount of the deduction for wear and tear for that year, and deemed to be part of that deduction, or, if there is no such deduction for that year, be deemed to be the deduction for that year, and so on for succeeding years."

Section 32 of the Finance Act, 1926, introduced a new Rule 11(2) to Cases I and II of Schedule D which is as follows :

"If at any time after the said fifth day of April any person succeeds to any trade, profession or vocation which until that time was carried on by another person and the case is not one to which paragraph (1) of the Rule applies, the tax payable for all years of assessment by the person succeeding as aforesaid shall be computed as if he had set up or commenced the trade, profession or vocation at that time, and the tax payable for all years of assessment by the person who until that time carried on the trade, profession or vocation, shall be computed as if it had then been discontinued."

It should be mentioned here that Section 29 of the English Finance Act, 1926, abolished the rule by which the profits of the business were assessed on the average of the previous three years and substituted therefor the profits of the single previous year. It may be, though I speak with no authority upon it, that Section 32 of the Finance Act, 1926, was considered necessary to give proper effect to the operation of Section 29 of the same Act. It should be noted that at all material times under the Indian income tax Acts the profits of the single previous year have been the basis of assessment.

Reference has been made to the case of the United Steel Companies Ltd. v. Cullington (1940) A.C. 812 : 9 ITR Supp. 20. There the appellant Company was incorporated in 1930 to acquire the undertakings of, and to amalgamate, two steel companies respectively formed in 1918 and 1920 on the terms of a scheme sanctioned by an order of Court under the Companies Act, 1929, Sections 153 and 154. The scheme was carried out and the undertakings and properties of the two old component companies were vested in the appellant company in return for shares. The two old companies being dissolved, the new company took over their business as from August 22, 1930.

The business of the two companies had been carried on at a loss for several years before the amalgamation. For the year 1936-37 the appellant Company claimed to set off against its assessment for income tax inter alia the wear and tear allowance of the two old component companies for the years before the amalgamation in accordance with Rule 6 of the Rules applicable to Cases I and II of Schedule D of the English income tax Act, 1918, notwithstanding the new Rule 11 of the same Rules substituted by the Finance Act, 1926, Section 32.

It was held that this could not be done.

Section 154 of the English Companies Act, 1929, provides for the making of an order transferring to a transferee company the whole or any part of the

undertaking and the property or liability of any transferor company.

Reliance has been placed upon the words of Lord Romer in his speech at page 828 of (1940) A.C. which run as follows :

"It must be conceded that were it not for the change in the law effected by Section 32 of the Finance Act, 1926, the appellants would have been entitled to deduct from their profits for the year ending April 5, 1937, the aggregate of the wear and tear allowances that had been made to the Strip Company up to August 22, 1930. For on this latter date the appellants succeeded to and continued thereafter to carry on the very same trade that up to then had been carried on by the Strip Company. The allowances would accordingly by reason of the provisions of sub-section 3 of Rule 6 of the Rules applicable to Cases I and II of Schedule D, income tax Act, 1918, be added to the amount of the deduction for wear and tear for the year of assessment in question and deemed to be part of that deduction".

(1940) A.C. 819 Lord Caldecote appears to express a somewhat similar view.

Regard, however, must be paid to the words of Lord Maugham in the same case at pages (1940) A.C. 821. and (1940) A.C. 882 which are in these terms :

"I will begin by observing that the right under Rule 6 is not a chose in action or an asset of the tax-payer, and that it could not be assigned to the appellants. It relates only to deductions allowable to a tax-payer in charging the profits or gains of a trade as representing the diminished value by reason of wear and tear of machinery or plant used in the trade by and belonging to the tax-payer. Sub-rule 3 of Rule 6 allows the deduction to be added by the tax-payer to the amount of the deduction in a subsequent year if there has not been a previous opportunity of making the deduction out of profits. It is clear that if the trader goes out of business this right to carry forward a deduction is lost, unless indeed there is a statutory right given to some other trader, presumably a successor, to deduct the diminished value (by wear and tear) of machinery and plant used by the predecessor from the profits or gains of the successor. It will be remarked that the machinery and plant might have been placed on the scrap-heap, or perhaps acquired by the successor for a very small sum. It is a little difficult to see the reason in such a case for giving to the successor the right claimed. But there is always a possibility of finding in the twists and turns of the income tax maze some relief or refug for the harassed tax-payer, and this possibility we must now examine....."

Again (1940) A.C. 823 :-

"To my mind it is clear that there is no possibility or reading into the Rule, i.e., 11(2), or any other existing rule to which we were referred, a right to exercise the remarkable privilege contended for, namely, of deducting from profits made after a previous business has been discontinued the diminished value of plant and machinery which the successor has perhaps never acquired".

At page 826 of (1940) A.C. Lord Russell of Killowen said :-

"The right here claimed is not only personal to the old companies, but is a right which can only be asserted in relation to income tax payable by them respectively in respect of the profits of the trades carried on by them respectively; and even assuming that the order of Eve, J., operated to vest that right in the appellants, it does not become in transitu a right exercisable in regard to income tax payable by the appellants in respect of the profits of the trade carried on by the appellants."

Lord Wright, at page 827 of (1940) A.C., said :-

"I question whether the claim to an allowance under Rule 6 of the Rules applicable to Classes I and II of Schedule D of the income tax Act, 1918, can properly come under the description of a property, right or power. But in any case the old companies never had any such right or property or power, however it is described, in respect of these allowances. All they had was a claim to allowances from their own profits in respect of wear and tear or losses. Neither company during its existence ever had profits or gains from which the deductions now claimed in whole or in part could have been made. The appellant company has been carrying on its own trade as from 1930, and it is in respect of the profits of that trade that the allowances are claimed. The old companies never had any interest in the trade. Their own trade ceased in 1930.

This I think is a sufficient answer....."

The views of Lords Maugham, Russell of Killowen and Wright seemed to be opposed to those of Lords Caldecote and Romer on the question of the transfer of the unabsorbed depreciation, if Rule 11(2) is left out of consideration. Their Lordships however all arrived at the same result.

It has been repeatedly said that decisions of English income tax cases are not precedents under the Indian income tax Act. It has been pointed out many times that the Indian income tax Act is different from the English income tax Act in wording and effect. The present case must be decided on the wording of the Indian income tax Act alone taken as a whole.

It must be remembered that in the present case the Indian Iron and Steel Company did not but the shares of the Bengal Iron Company and run the Bengal Iron Company as an existing concern. What the Indian Iron and Steel Company did was to buy the assets of the Bengal Iron Company when it went into liquidation. They paid for them less than their cost. This fact was admitted in argument and is clear from an examination of the returns made by the assesseees.

For instance, the Bengal Iron Company's depreciation before the transfer for eight months was Rs. 8,62,329 and, therefore, for a whole year Rs. 12,93,394. The Appellate Officer in his order dated August 21, 1939, which is Annexure E, stated the Bengal Iron Company's assets depreciation to be "on Bengal Iron Company's assets on the cost to the appellant- Rs. 11,33,301." Put another way, the assets

in respect of which depreciation is claimed were taken over by the assessee at a depreciated figure, though perhaps not the figure at which they stood in the Bengal Iron Company's books.

To ascertain the nature, purpose and effect of the depreciation allowance, Section 10 of the Indian income tax Act must be examined.

Summarizing the relevant part of Section 10, sub-section (1) provides that the tax shall be payable by an assessee in respect of the profits or gains in any business carried on by him. Sub-section (2) provides that the profits shall be computed after making the following allowances :

"(iv) in respect of insurance against risk of damage or destruction of buildings, machinery, plant, furniture, stocks or stores, used for the purposes of the business...." and

"(iv) in respect of depreciation of such buildings, machinery, plant, or furniture being the property of the assessee, a sum equivalent to such percentage on the original cost thereof to the assessee....."

Proviso (b) states that where full effect cannot be given to "such allowance" in any year, "the allowance or the part to which effect has not been given shall be added to the amount of depreciation for the following year and so on for succeeding years."

In the whole of the section there is no mention of a change in the ownerships of the business, nor any suggestion that the allowance is available to the successor. If it had been intended, to make this allowance available to the successor to the business, the following words could well have been added to the end of proviso (b) : "Where the business is carried on by an original owner of the business or his successor." No such words are to be found.

The effect of Section 26(2) of the Indian income tax Act, in my view, is simply to provide that as regards the year of assessment, where a succession has occurred in the ownership of the business in the previous year, the successor is made liable to pay income tax for that year on the total profits actually earned by the business during the previous year, i.e., the one in which the succession occurred—whether earned under the predecessor or the successor.

Section 26(2) says nothing as to any right of the successor to take advantage of the unabsorbed depreciation his predecessor might have been entitled to. If the Legislature had intended by this sub-section to transfer, or make transferable the unabsorbed depreciation, it would have provided for it in express terms.

It is clear from the Act that an assessee is entitled to the depreciation allowance in respect of wear and tear to his buildings, plant, machinery, etc., based on its cost to him whilst he is carrying on his business; it is clear also that he may carry forward the unabsorbed balance of this allowance as long as he carries on his business, but nowhere is it provided that his successor may acquire this

benefit when he acquires his predecessors business.

Lord Caldecote in the United Steel Companies Case (1940) A.C. 812(1940) A.C. 823 : 9 ITR 20., (1940) A.C. 818, speaking of depreciation allowances under the English income tax Acts said :

"The deductions claimed are by way of relief from the liability to pay income tax upon profits or gains, and the taxpayer must establish his claim upon correct interpretation of the language of the material enactments."

Applying that pronouncement, (which is of a general character and not based on any particular wording of the English income tax Acts), in this case the position is that u/s 10(1) of the Indian income tax Act the tax is payable by the assessee on the profits and gains of any business carried on by him; since no exemption from tax is expressly given anywhere in the Act to the successor arising from the unabsorbed depreciation allowance of the predecessor, therefore none is given.

The depreciation allowance therefore, being a deduction permitted to the assessee under income tax Act in respect of wear and tear of his plant and machinery based on its cost to him against the profits he may make when carrying on his business, is a statutory privilege personal to him so long as he carries on his business. When he ceases to pay income tax on his business profits through ceasing to carry on his business, the permission to deduct ceases; it is not a right which passes to his successor under the income tax Act, nor is it a right which he can transfer by agreement.

In reaching the above conclusions I believe I have arrived at the same views as to the general nature and operation of depreciation allowances as those expressed by Lords Maugham, Russell of Kilowen and Wright who formed the majority in the House of Lords in the United Steel Companies case (1940) A.C. 812 : (1940) A.C. 8239 ITR 20. The result, though derived through different provisions of law, is the same. Lord Maugham referred to the claim to succeed to depreciation allowances as "a right to exercise the remarkable privilege of deducting from profits made after a previous business has been discontinued the diminished nature of the plant and machinery which the successor has perhaps never acquired".

The assessee in the present case brought the undertaking and assets of the Bengal Iron Company "and the benefit so far as it is capable of being acquired of any claim which the Bengal Iron Company may have in respect of unabsorbed depreciation allowances".

The assessee took a shrewd and, in my view, accurate view of the legal nature and effect of the Bengal Iron Companys unabsorbed depreciation allowance as the wording of the clause relating to it shows. They knew it was doubtful whether they could acquire it but they took it for what it was worth and have made the best of their claim to it. To have acceded to their claim would have been to read into the income tax Act something which it did not contain. The effect to the

assesseees in so doing would have been to give them immunity from taxation in respect of future profits to the amount of Rs. 90,31,317 simply because the Bengal Iron Company had made small profits or suffered losses in the past when the assessee company had nothing to do with the Bengal Iron Company's business. A further and more general result would be to put a premium on the sale value of depreciated unsuccessful business undertaking at the expense of the general taxpayer. But for the reasons I have given, in my view, the law does not lead to such results.

As regards the computation of the depreciation allowances for the period since December 2, 1936, those allowances are based on the cost of the plant, etc., to the assessee-the Indian Iron and Steel Company, Limited. See Section 10(2)(vi) of the Act and the case of COMMISSIONER OF INCOME TAX, MADRAS Vs. THE BUCKINGHAM and CARNATIC COMPANY, LIMITED, MADRAS., .

As regards the period April 1, 1936, to December 2, 1936, the allowances are based on the cost of the plant, etc., to the person who carried on the business during that period, i.e., on the original cost of such plant, etc., of the Bengal Iron Company, Limited. This follows from what I have said above and from Section 26(2) of the Act and also from the decision in the case of COMMISSIONER OF Income Tax, BOMBAY Vs. THE MAZAGAON DOCK LTD., .

For the reasons I have given above I am of the opinion that the assessment made by the Assistant Appellate Commissioner of income tax in this case was right and that the questions asked in the reference should be answered as follows :-

(1) Whether in assessing, under the provisions of Section 26(2) of the Indian income tax Act, in the circumstances of the present case, a person succeeding to the business of another, the income of the business of the latter up to the date of succession should be assessed to tax separately, or whether the assessment should be made in respect of such business as if it had throughout the year of succession been carried on by the successor ?

This question is involved and difficult to answer as asked; the best answer to it is that the Appellate Assistant Commissioner's assessment as summarized in paragraph 5 of the case is correctly made.

(2) Whether in the circumstances of this case the Indian Iron and Steel Company, Limited, was entitled in law in its assessment for 1937-38 to have the whole of the depreciation allowance on the buildings, machinery, etc., of the Bengal Iron Company acquired by it computed on the original cost of such assets to the Bengal Iron Company ?

The answer is as indicated above-No.

(3) Whether in the facts and circumstances stated above the assessee company in its assessment for 1937-38 and subsequent years is entitled in law to the benefit of the unabsorbed depreciation allowance of Rs. 85,45,150 of the Bengal

Iron Company, Limited ?

The answer is-No.

We make no order as to costs.

PANCKRIDGE, J. - Of the three questions raised by this Reference, the third is of very great importance, not only to these assessee, but in all probability, having regard to the increasing tendency in modern commerce and industry towards merger and amalgamation, to many other assessees. It is also of great importance to the Revenue authorities. In times of depression profits are small or non-existent. Meanwhile the unabsorbed depreciation allowance goes on increasing, so that it is not difficult to conceive a situation, where, if the argument on behalf of the assessee is well-founded, the principal attraction for the purchase of a moribund business will be a considerable unabsorbed depreciation balance, which will be used by the purchaser to set against his own trading profits, and to enable him to avoid the payment of income tax until it is exhausted.

I will very briefly recapitulate the facts which are of no great complexity.

The assessees are a rupee company, and in 1936 an elaborate scheme was devised whereby the assessees undertook to acquire the whole undertaking of the Bengal Iron Company, Limited, which was a sterling company incorporated in England, and which I shall henceforward call the Bengal Company.

It is common ground that the assessees succeeded to the business of the Bengal Company within the meaning of Section 26(2) of the Indian income tax Act, 1922, (as that section stood before the recent amendment), on December 3, 1936.

The transfer was in terms of an agreement in writing dated September 8, 1936, a copy of which, together with the scheme of arrangement and amalgamation attached thereto, is Annexure "A" to the latter of reference.

At the date of the transfer the unabsorbed depreciation allowance, to which the Bengal Company were entitled under the provisions of Section 10(2)(vi) of the Act and the proviso thereto, amounted to Rs. 85,45,150.

It was thought prudent to make it clear in the agreement that the assessee were, if possible, to have the benefit of this balance as from the date of the transfer of the assets, and clause 3(a) of that document provides that the undertaking, properties, and assets of the transferor company shall included the benefit, so far as capable of being assigned, of any claim which the transferor company may have in respect of all unabsorbed depreciation allowances.

The position of the assessees at the time of the assessment for 1937-38 was that they were entitled in respect of their original business to an unabsorbed depreciation allowance of Rs. 62,00,775.

The assessment for 1937-38, based on the profits and gains of the assessee's business for the previous year, as made by the income tax Officer and as subsequently modified by the Appellate Assistant Commissioner, is as follows.

In applying the provisions of Section 26(2) of the Act the assessment divides the previous year into the period prior to December 3, 1936, and the period subsequent thereto December 3, 1936, is admittedly the date when the succession took place. The assessment allows current depreciation on the Bengal Company's assets for the first period computed on the original cost to that company. For the second period current depreciation has been allowed on these assets computed on their cost to the assessee, that is to say, to the successors to the business, namely, the Indian Iron and Steel Company, Limited.

It is admitted with regard to the assessments for the years succeeding 1937-38, that in view of the decision of the Judicial Committee in the COMMISSIONER OF INCOME TAX, MADRAS Vs. THE BUCKINGHAM and CARNATIC COMPANY, LIMITED, MADRAS., , current depreciation must be reckoned on the basis of the price paid for the Bengal Company's assets by the present assessee.

The assessee and the income tax authorities are also agreed that the current depreciation on the assets must be computed on their original cost to the Bengal Company, at any rate with regard to that portion of the previous year prior to the succession. This is in recordance with the decision of the Bombay High Court (Beaumont, C.J., and Rangnekar, J., Blackwell, J., dissenting) in COMMISSIONER OF Income Tax, BOMBAY Vs. THE MAZAGAON DOCK LTD., .

The only difference between the assessee and the Revenue with regard to current depreciation allowance is this.

The assessee maintains, on the language of Sec. 26(2), that the authorities are wrong in splitting the year of succession into two periods, and that current depreciation should be computed as if the business had been the predecessor's business for the whole of the previous year, in respect of which the assessee is liable to be assessed by reason of the sub-section. Having regard to the magnitude of the sums involved, the practical difference between the two methods as regards the year of assessment is not very great.

For the four post-succession months current depreciation computed on the cost to the Bengal Company would be Rs. 4,31,000 odd, while on the basis of the cost to the assessee they have been allowed Rs. 3,77,000 odd as current depreciation on the assets taken over. Moreover if the authorities are right in their treatment of the unabsorbed depreciation allowances of the Bengal Company, it appears that the "split" previous year favours the assessee.

The reason for this is that the authorities have allowed the current depreciation of Rs. 3,77,000 to be taken into the general depreciation account of the assessee, and added, together with the current depreciation allowance on their original assets, to their unabsorbed depreciation balance.

If current depreciation had been reckoned for the whole of the previous year on the cost to the Bengal Company, the assessee would have had no advantage from it whatever, for the unabsorbed depreciation allowance of the Bengal Company, the benefit of which has been refused to the assessee, would merely have been increased by Rs. 4,31,000.

The real point at issue concerns the accumulated unabsorbed depreciation allowances of the Bengal Company.

On March 31, 1936, these stood at Rs. 85,45,150 and unquestionably by virtue of proviso (b) to Sec. 10(2)(vi) that Company was entitled to bring them forward to the next year.

The Assistant Commissioner has permitted this sum to be brought forward and added to the current depreciation allowance for the pre-succession period, the result being a sum of Rs. 94,07,479. From this he has deducted Rs. 3,76,162 being the Bengal Company's profits for this period. But he has ruled that the assessee is not to be given credit for any further benefit from the balance thus arrived at of Rs. 90,31,317.

The assessee says that they are entitled to add this balance to the balance of Rs. 36,84,324 which the Assistant Commissioner has found to be their unabsorbed depreciation allowance on March 31, 1937. This sum has been arrived at by adding the unabsorbed depreciation allowance of the assessee brought forward from 1935-36 to the current depreciation on their original assets for 1936-37, and on the Bengal Company's assets for the post-succession period, and then subtracting therefrom the profits of the original business for the entire year and the profits of the acquired business for the four post-succession months.

At the request of the assessee the Commissioner of income tax has referred the following questions to this court :

- (1) Whether in assessing, under the provisions of Sec. 26(2) of the Indian income tax Act, in the circumstances of the present case, a person succeeding to the business of another, the income of the business of the latter up to the date of succession should be assessed to tax separately, or whether the assessment should be made in respect of such business as if it had throughout the year of succession been carried on by the successor ?
- (2) Whether in the circumstances of this case the Indian Iron and Steel Company, Limited, was entitled in law in its assessment for 1937-38 to have the whole of the depreciation allowance on the buildings, machinery, etc., of the Bengal Iron Company acquired by it computed on the original cost of such assets to the Bengal Iron Company ?
- (3) Whether in the facts and circumstances stated above the assessee company in its assessment for 1937-38 and subsequent years is entitled in law to the benefit of the unabsorbed depreciation allowance of Rs. 85,45,150 of the Bengal Iron Company Limited ?

I do not think that the first question requires a separate answer. Read with the second question, it calls upon us to decide whether the Assistant Commissioner was right in computing current depreciation on the Bengal Companys assets on one basis up to the date of transfer, and on a different basis thereafter. COMMISSIONER OF Income Tax, BOMBAY Vs. THE MAZAGAON DOCK LTD., affords no direct guidance on the point, as there the succession occurred on the first day of the financial year. It followed that the profits and gains of the previous year on which the successor was assessed were all profits and gains made by the predecessor.

I confess I do not altogether understand the decision of the Allahabad High Court in KAMLAPAT MOTI LAL IN RE., . From page 391 of the report it appears that the income tax authorities "split" the year of secession in a manner which resembles the method employed in this case : the Court referred to the COMMISSIONER OF Income Tax, BOMBAY Vs. THE MAZAGAON DOCK LTD., and observed as follows :

"It is clear that an assessment under Sec. 26(2) is not made on the profits actually received by the successor referred to in that section and is at best a hypothetical or notional assessment. The assessment is made on the supposition that the whole of the profits for the "previous year" were received by the successor even though the whole or a part of those profits must have been received by his predecessors. In other words, the successor is, for the purposes of assessment u/s 26(2), to be assumed as his predecessor with respect to the previous year and the profits have to be computed on this assumption. That being so, in the computation of the profits for the "previous year" deduction must be made with respect to all the allowances enumerated in sub-section (2) of Section 10 to which the predecessor may have been entitled".

If the Court considered that it followed from the COMMISSIONER OF Income Tax, BOMBAY Vs. THE MAZAGAON DOCK LTD., that a successor assessee is entitled to claim depreciation reckoned on the costs of the assets to his predecessor over the whole of the previous year, including that part of it when the assets were the successors, and the profits and gains made were made by him, I am of opinion that the decision is erroneous.

The assessees attach much importance to the language of Section 26(2), especially to the provision that the assessment shall be made on the person succeeding as if he had been carrying on the business throughout the previous year, and as if he had received the whole of the profits for that year.

In my opinion, to arrive at a proper construction of the subsection regard must be had to its object. That object is to make the successor liable to be assessed on profits and gains made by the predecessor. A special section is not necessary to make the successor assessable on the profits and gains of the business from the date at which he becomes the owner.

It appears to me to follow that as regards current depreciation, he is only entitled to the allowances claimable by his predecessor in respect of the profits

and gains on which the predecessor would be liable to be taxed except for the section.

To bear the construction for which the assessee contends the section would have to provide that the succession should be deemed to have taken place at the close of the previous year. I think question (2) could be answered thus : "No. The Indian Iron and Steel Company, Limited, were entitled to have depreciation computed on the original cost to the Bengal Iron Company, Limited, only from April 1, 1936, to December 3, 1936".

I now pass to the question of the Bengal Company's unabsorbed depreciation allowance. The assessee claims to have transferred it to their accounts.

In *United Steel Companies, Limited v. Cullington* (1940) A.C. 812 : 9 ITR 20, Viscount Maugham at page 823 of 1940 A.C. described a claim, somewhat similar to the claim of the assessee in this case, as one for "a remarkable privilege".

It would certainly seem astonishing if the assessee were entitled to use this immense unabsorbed allowance to protect the profits, not only of the business they have acquired, from taxation, but also the profits of their original business.

They specifically claim to take the unabsorbed balance into general depreciation account and use it to set against their entire future profits, although they are compelled to admit that the limitation imposed by proviso (c) to sub-clause (vi) must be read with reference only to the assets taken over from the Bengal Company. On the other hand, it may be said that the fact that in this case the successor has a business of his own is accidental, and that it seems unjust that a business should lose the privileges the law gives to it in the hands of its original owner, merely because it passes to another by inheritance, bequest or assignment.

Like all questions of this character it must be decided solely on the language of the statute.

Now with regard to this I have come to the conclusion that the Commissioner of income tax is right in the importance he attaches to the limitation imposed by the words "such allowance" in proviso (b). In other words, the proviso can only apply to the allowances that fall within the ambit of sub-clause (vi).

Under section 10(1) the tax is payable by an assessee under the head "Business" in respect of any profits or gains of any business carried on by him.

Sub-section (2) deals with allowances.

Sub-clause (vi) provides for an allowance in respect of depreciation of a sum equivalent to such percentage on the original cost of the assets to the assessee as may in any case or class of cases be prescribed.

Proviso (b) deals with the bringing forward of such allowances which are wholly

or in part unabsorbed by profits.

Therefore, the assesseees can only claim to bring forward allowances computed on the original cost of the assets to them. But what they in fact claim to bring forward are allowances computed on the original cost, not to them, but to the Bengal Company or, in other words, allowances which are outside the scope of the proviso.

To my mind this completely disposes of the assesseees contention and I agree that the answer to question 3 must be in the negative.

This is really enough, and possibly more than enough for the purposes of this Reference.

I feel, however, that I should not omit to deal with the United Steel Companies Limited. v. Cullington (1940) A.C. 812: 9 ITR 20, because although the House of Lords unanimously rejected the appellants claim to set off against their own profits, allowances for wear and tear which the Companies, the appellants, had acquired would have been entitled to carry forward against future profits, had they continued to trade, yet it was recognised that the claim would have been sustainable but for the change in the law effected by Section 32 of the Finance Act, 1926.

I have, therefore, examined the rules as to wear and tear as they stood prior to the passing of that statute.

Rule 6(1) to Cases I and II of Schedule D is concerned with wear and tear and runs as follows :

"In charging the profits or gains of a trade under this Schedule, such deduction may be allowed as the commissioners having jurisdiction in the matter may consider just and reasonable, as representing the diminished value by reason of wear and tear during the year of any machinery or plant used for the purposes of the trade and belonging to the person by whom it is carried on".

Rule 3 makes provision for the carrying forward of such deductions in terms closely resembling those of our proviso (b).

The difference, however, is obvious. The deduction for wear and tear is fixed by the Commissioners on a just and reasonable basis provided that the conditions of the rule are satisfied. There is no reference to the original cost to the assessee whose profits and gains are being taxed.

There is nothing, therefore, to prevent the provisions as to carrying forward continuing to be effective after a person in the words of Rule 11 "succeeds to the trade".

Under the Indian income tax Act the situation is different, inasmuch as the allowances must be directly connected with the assessee before the proviso can have any application.

I formally concur with the answers to the question as framed by my Lord, the Chief Justice.

Reference answered accordingly.